

Depository Receipts in India- Will SEBI Murder It?: Analysis of the SEBI Circulars Dated Oct 10, 2019 and Nov 28, 2019 Regarding Framework for Issue of Depository Receipts

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ABSTRACT

Depository Receipts (DRs), a structured financial derivative instrument was introduced by the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993. Further, the Depository Receipts Scheme, 2014 (2014 DR Scheme) in consonance with the Companies Act, 2013 and other laws started regulating the DRs. After witnessing several manipulative and fraudulent DR Structures in the last decade, the Securities and Exchange Board of India has debarred and penalised several participants and also imposed strict restrictions on DR issuances by rules and Circulars; “Framework for issue of Depository Receipts” on Oct 10, 2019 and Nov 28, 2019 have purported the same. These Circulars have imposed restrictions on eligibility criteria, DR jurisdictions, etc. making the DRs virtually impossible to issue at reasonable cost. This paper aimed at analysing the 2019 Circulars using doctrinal interpretation and literature review to understand if it’s a beginning of the end of DRs from India. The paper found that many restrictions were imposed on the DR issuances whereas “Direct Overseas Listing” may rise up as an alternative instrument for unlisted and mid-cap Indian companies to explore international capital market.

Keywords: Circular, Depository Receipts, Direct Overseas Listing, India, SEBI

1. INTRODUCTION

Depository Receipts (DRs), includes Global Depository Receipts (GDRs) and American Depository Receipts (ADRs), are foreign currency denominated derivative instruments which are issued by a foreign depository (the Depository) and carry underlying securities of a domestic issuer (Desai, 1999; Kousalya & Niranjana, 2017; Kumar, 2006). DRs, though conceptualised globally in 1927 (Feigen, 1999), were first introduced in India by the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 which has regulated DR issuances up to 2014.

In 2014, the Depository Receipts Scheme, 2014 (2014 DR Scheme) and the Companies (Issue of Global Depository Receipts) Rules, 2014 (GDR Rules) were laid down by the Securities and Exchange Board of India (SEBI). Thereafter, SEBI and the Central Government have been regulating DR issuances in consonance with the Companies Act, 2013 (the Companies Act), the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (FEMA), Prevention of Money-Laundering Act, 2002 (PMLA) and other laws.

In the last decade, from 2010-20, SEBI has observed many fraudulent DR issuances, so, it debarred and penalised several companies and directors and participants associated with such manipulative schemes. In wake of such malpractices, SEBI has imposed strict restrictions on DR issuances by rules and Circulars. SEBI, by exercising its powers conferred by the Securities and Exchange Board of India Act, 1992 vide Section 11(1), issued two Circulars with subject “Framework for issue of Depository Receipts” on Oct 10, 2019 and Nov 28, 2019 following the Central Government notifications.

The Circular dated Oct 10, 2019 (the Circular or October Circular) brought many changes to the 2014 DR Scheme and GDR Rules restricting eligibility criteria, DR jurisdictions, etc. Circular dated Nov 28, 2019 (November Circular) has supplemented October Circular by providing Annexure A containing 'List of Permissible Jurisdictions and International Exchanges'. Both the Circulars are restrictive and many authors considered them as "the beginning of the end of DRs from India" (Verma, 2019) as an alternative instrument to the DR, Direct Overseas Listing was allowed in 2020 by amending the Companies Act. Hence, this paper attempts to critically analyse the 2019 Circulars and along with available literatures and assess the legal and economic effect of these circular on upcoming DR issuances. It will also evaluate if the "Direct Overseas Listing" permitted by the laws will deter the DR issuances from India.

This legislative review study holds significance as it brings legal scholarship and highlights the issues related to regulatory policy, corporate finance, and international investments through foreign direct investments (FDI). It also touches the malpractices associated with the DR instrument and, hence, it may help or guide policymakers in protecting stakeholders in Indian capital market by understanding the law, its effect and available alternatives.

2. LITERATURE REVIEW

2.1. Provisions of the Circular

October Circular, the most awaited Circular for DRs has affected many amendments in the DR framework. Most participants were astonished with its provisions which are briefed below.

2.1.1. Eligibility Criteria

Importantly, the October Circular has altered the eligibility criteria of issuing DRs by Indian companies. Vide this Circular, only Indian companies listed on Recognized Stock Exchange in India ('Listed Companies') are permitted to issue DRs. Additionally, Listed Companies will have to comply with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) and other prevailing laws for issuing DRs. The October Circular further prohibits the Listed Companies from issuing DRs if they or their promoters or director are wilful defaulters or fugitive economic offenders or have been debarred from accessing the capital market by SEBI and debarment is not ceased.

2.2. Un-sponsored DRs

An un-sponsored DRs, mean DRs issued without specific approval of the Listed Company (Datta, 2015), were permitted under the 2014 DR Scheme. Under the October Circular, the Listed Company will have to deposit the securities held by existing shareholders with the custodian. Also, the Listed Companies are responsible for sharing information with the international exchange where DRs are listed. Hence, indirectly there will be need of consent and approval from the Listed Company. In such way, un-sponsored DRs are disallowed (Rajeevan & Dubey, 2019) by 'Explanation 4' of this Circular. Listed Companies will have to provide an opportunity to its existing equity shareholders for participation in such listing of DRs.

2.3. Permissible Jurisdictions

'Permissible Jurisdictions' and 'International Exchanges' were the vital elements of the October Circular, though, the list of jurisdictions and exchanges was provided in November Circular as Annexure A, stated below:

Table 1. Permissible Jurisdictions

No.	Permissible Jurisdiction	International Stock Exchange
1.	United States of America	NASDAQ Stock Market The New York Stock Exchange
2.	Japan	Tokyo Stock Exchange
3.	South Korea	Korea Exchange Inc.
4.	United Kingdom excluding British Overseas Territories	London Stock Exchange
5.	France	Euronext Paris
6.	Germany	Frankfurt Stock Exchange
7.	Canada	Toronto Stock Exchange

No.	Permissible Jurisdiction	International Stock Exchange
8.	International Financial Services Centre (IFSC) in India	India International Exchange NSE International Exchange.

2.4. Obligation of Listed Company

The October Circular has made Listed Companies responsible for compliance requirements of FEMA, PMLA, the Companies Act and related rules and regulations. The Listed Companies also have to ensure compliance to requirement of 25% public shareholding under LODR (Rajeevan & Dubey, 2019), foreign shareholding limits under FEMA and 'Permissible holder' & 'Beneficial Ownership' under relevant provisions. The Listed Company is also required to file the Offering Circular or Prospectus with SEBI for their comments and approval and with recognized stock exchanges for in-principle approvals. The Circular has also made Listed Company responsible for making public disclosures on international stock exchanges on which DRs are listed and all such disclosures are also to be provided to Recognised Stock Exchanges within 24 hours.

2.5. Permissible holder

The October Circular stated that 'Permissible Holder' including 'Beneficial Owner' of DRs must not be a person resident in India and Non-Resident Indian (NRI).

2.6. Voting Rights

This Circular bestowed responsibility on the Listed Company to ensure that the voting rights related Permissible Securities underlying the DRs have been exercised by DR Holder with the help of the Depository.

2.7. Pricing

The Circular further added a provision which states that where there is simultaneous listing of the securities in India and foreign jurisdiction by way of DRs, the price of underlying securities of the DRs could not be less than price of securities in India.

2.8. Obligations of Indian Depositories, the Depository and Indian Custodian

Indian depositories, by way of establishing or developing a system, are obliged to ensure that foreign holding does not exceed the threshold stated by the FEMA and SEBI. The Circular also made Indian Custodian accountable for maintaining records of DR issued or cancelled and conveying such information to the Indian depository. This October Circular also restricts the Depository from issuing the DRs without confirmation of the receipt of underlying Permissible Securities by the Custodian.

2.9. Power to remove difficulties

The Circular also has 'Henry VIII clause' which allows SEBI to issue clarifications through guidance notes or circulars if there is any difficulties in the application or interpretation or relaxation is sought by the Issuer.

3. RESEARCH METHODS

This research paper employed a qualitative, secondary, and doctrinal legal research methodology based on literature review to critically examine the impact of SEBI's 2019 Circulars related to "Framework for issue of Depository Receipts" on the viability and prospects of DRs as an instrument for Indian companies to access international capital markets. The doctrinal approach was selected for analysing binding legal instruments including but not limited to rules, circulars, the 2014 DR Scheme, laws like PMLA, LODR, FEMA, Securities Contracts (Regulation) Act, 1956 (SCRA) and the Companies Act, 2013 and interpreting their practical and legal effects through logical reasoning and textual analysis. Further, several literatures are also reviewed and analysed relevant to the subject.

4. RESULTS AND DISCUSSION

Both the SEBI Circulars have altered many existing provisions of the 2014 DR Scheme. In fact, these Circulars have restricted the scope of DRs which was liberalised by the 2014 DR Scheme. Also, these Circulars have amended provisions of the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (PML Rules).

4.1. Positives of the Circular

The 2014 DR Scheme was a liberal Scheme and had permitted DR issuances in 34 jurisdictions (Ministry of Finance, 2014). In wake of malpractices and fraudulent DRs issued by Indian companies, the November Circular provided the list of Permissible Jurisdictions in which highest level of listing standards, disclosures and compliances are required. This restriction on Permissible Jurisdiction will definitely curb the fraudulent DR issuances and protect investors, Indian and foreign, from such illicit DR issuances witnessed in India during the last decade.

The Circular has also curtailed the meaning of “Permissible Securities” as stated in the 2014 DR Scheme and restricted it to dematerialised equity shares and debt securities (Kale, 2019) whereas the term “Securities” under Section 2(h) of SCRA was exhaustive covers any marketable securities which may again be derivative marketable instruments. This restricted the DRs to underlie any marketable derivative instruments. The Circular has restricted the Issuer, Promoters or Directors to issue DRs if they are wilful defaulters, fugitive economic offenders or debarred from accessing the capital market. This may curb wilful defaults and also malpractices likely to be conducted by them.

The 2014 Scheme was ambiguous related to minimum shareholding and foreign holding requirements. Provisions 2.11 and 2.12 of the Circular have clarified the matter. The October Circular has not restricted it by verbatim but made it impossible to issue as the Listed Company became responsible to deposit the securities held by existing shareholders with the custodian and provide periodic information to the international exchange on which DRs are listed.

In the past, there have been many DR issuances without voting rights. At many instances, the Depository holding the DRs, uses their voting rights in favour of promoters, directors or management. Now the Depository will exercise voting rights only on the behalf of DR holders; it’s a good move in the interest of DR holders and corporate governance.

4.2. Critique of the Circular

The Circular permits issuance of DRs against existing shares but DRs shall be issued at a price, more than the price of Permissible Securities to domestic investors. Here, it lacks clarity on what would constitute a ‘corresponding mode of issue’ (Rajeevan & Dubey, 2019) and how it could affect DRs Pricing, etc. The Circular has only allowed Listed Companies to issue DR barring unlisted companies to access international capital markets by way of DRs. Unlisted companies or start-ups in the technology space may suffer from this prohibition (Asher, 2019). The 2014 DR Scheme, by expanding definition of securities, has included units of real estate investment trusts (REITs) and infrastructure investment trusts (InvITs). Now, the Circular has restrained REITs and InvITs from accessing the DR market (Rajeevan & Dubey, 2019).

Contrasting the 2014 DR Scheme, the Circular made the Listed Companies to file the preliminary offer document or prospectus mandatorily with SEBI for its comments. This review seems like excessive legislation and may prolong the DR issue (Rajeevan & Dubey, 2019). The Circular has also provided for “Deemed No Comments” if SEBI doesn’t provide comments within 7 working days limiting any further delay of the DR program. The Circular prohibits NRI and lacks clarity on issuance of DRs to NRI as Employee stock ownership plan (ESOP) or any share based employee benefit schemes which is implemented under SEBI (Share Based Employee Benefits) Regulations 2014. This ambiguity is clarified by issuing a new Circular on Dec 18, 2020 (SEBI Circular, 2020) stating that DRs to NRIs are allowed if it’s under Employee Benefits Regulation.

5. CONCLUSIONS

In the current DR market, several or most of DR transactions have followed fraudulent DR issuances or programs which were not only against the interests of domestic investors but also foreign investors; around 85% of foreign DR holders lost their money in their DR investment during 2010-2011. The SEBI DR Circulars were a sigh of relief and praiseworthy and a much needed step to curb malpractices associated with DRs. Also, the Circular has brought clarity on long due aspects like 'Beneficial Ownership', 'Voting Rights' and various obligatory requirements of participants.

The Circular has restricted 'Eligibility Criteria of Issuer' and 'Permissible Jurisdiction' which may affect DR issuances from Indian market and also fear that DR issuances may completely wipe and India may lose one vehicle to attract FDI. Nonetheless, this was needed to curb the menace created by fraudulent DR issuances.

Unlisted companies are restrained from accessing international capital markets via DRs and mid-cap listed companies may not afford the cost and compliance of listing DRs in Permissible Jurisdictions. These unlisted and mid-cap companies were reasonably relieved by the Amendment of the Companies Act on Sep 28, 2020 which allowed "Direct Overseas Listing". Indeed, this is against the conventional DR market or mechanism and likely to wipe out the DR market from India.

This paper, although a legislative review, aids policy makers in understanding the DRs, its declining trend, alternative instrument to attract FDI and act judiciously. It is worth mentioning that the policy makers need to check if the 2019 Circulars violates the "Proportionality Principle in Regulation" diminishing the DR issuances and see if the DRs and the Direct Overseas Listing can coexist and help to attract investments without any manipulative practices, and, strengthen, not only India but also global capital market.

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